

Financial Accounting Advisory Services

IFRS 15: The new revenue recognition standard



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IFRS 15: New requirements regarding recognition and timing of revenue

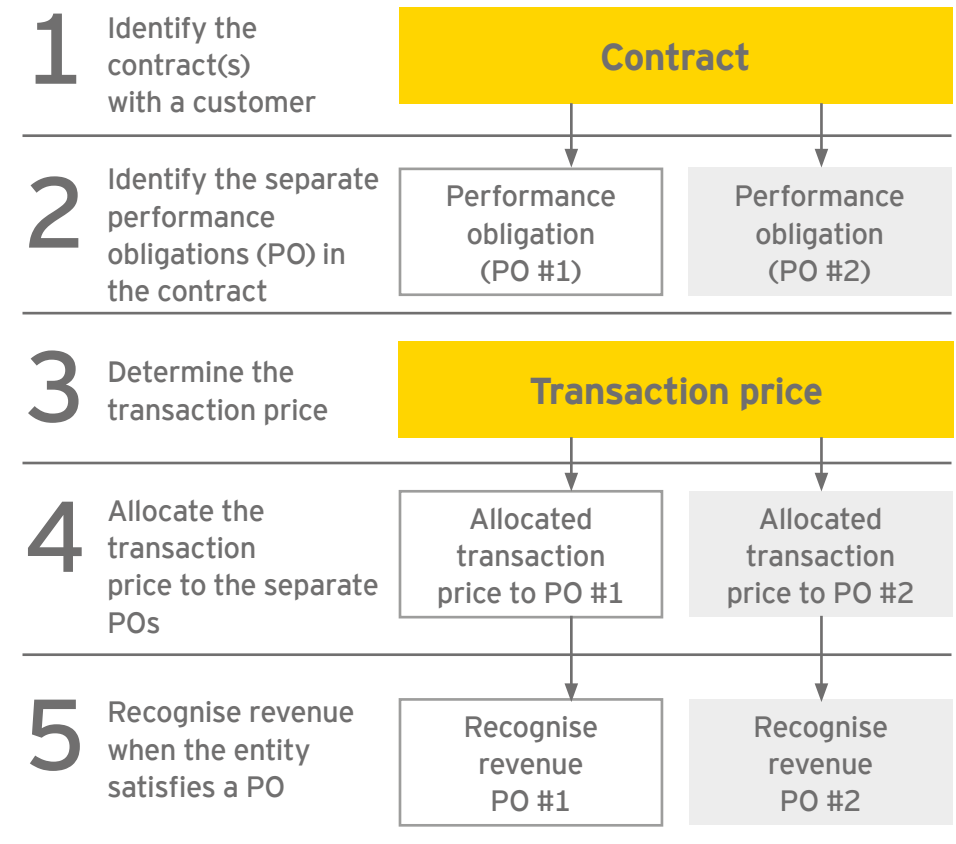
The IASB and the FASB have jointly issued a new revenue standard, IFRS 15 *Revenue from Contracts with Customers*, which will replace the existing IFRS and US GAAP revenue guidance.

- ▶ The new standard creates a single model for revenue recognition from contracts with customers.
- ▶ This single revenue recognition model will promote greater consistency and comparability across industries and capital markets.
- ▶ The new standard is effective for annual periods beginning on or after 1 January 2017.
- ▶ Early adoption is permitted for IFRS preparers.
- ▶ Early preparation will be key to successful implementation of the new standard.

This brochure provides you with an high level overview of the new requirements as well as how EY can assist you in applying these new rules.

IFRS 15: Five-step model

The principles in the standard will be applied using a five step model.



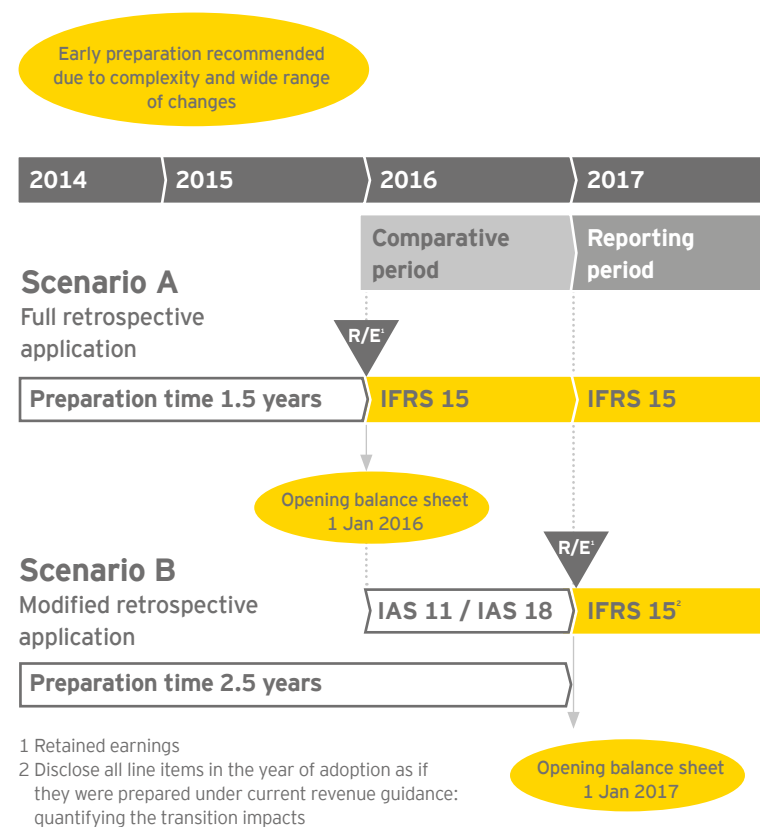
IFRS 15: Selected topics

Below are areas of potential changes and challenges according to the new standard.

- ▶ Combining contracts
- ▶ Contract modifications
- ▶ Variable consideration
- ▶ Rights of return, guarantees and warranties
- ▶ Costs to obtain a contract
- ▶ Costs to fulfill a contract
- ▶ Royalties/licenses
- ▶ Portfolio approach
- ▶ Customer loyalty programmes
- ▶ Methods for measuring progress for each PO
- ▶ Non-refundable upfront fees
- ▶ Put/call options
- ▶ Principal versus agent considerations
- ▶ Bill-and-hold arrangements
- ▶ Customers' unexercised rights (i.e., breakage)
- ▶ Presentation and disclosures
- ▶ Transition requirements

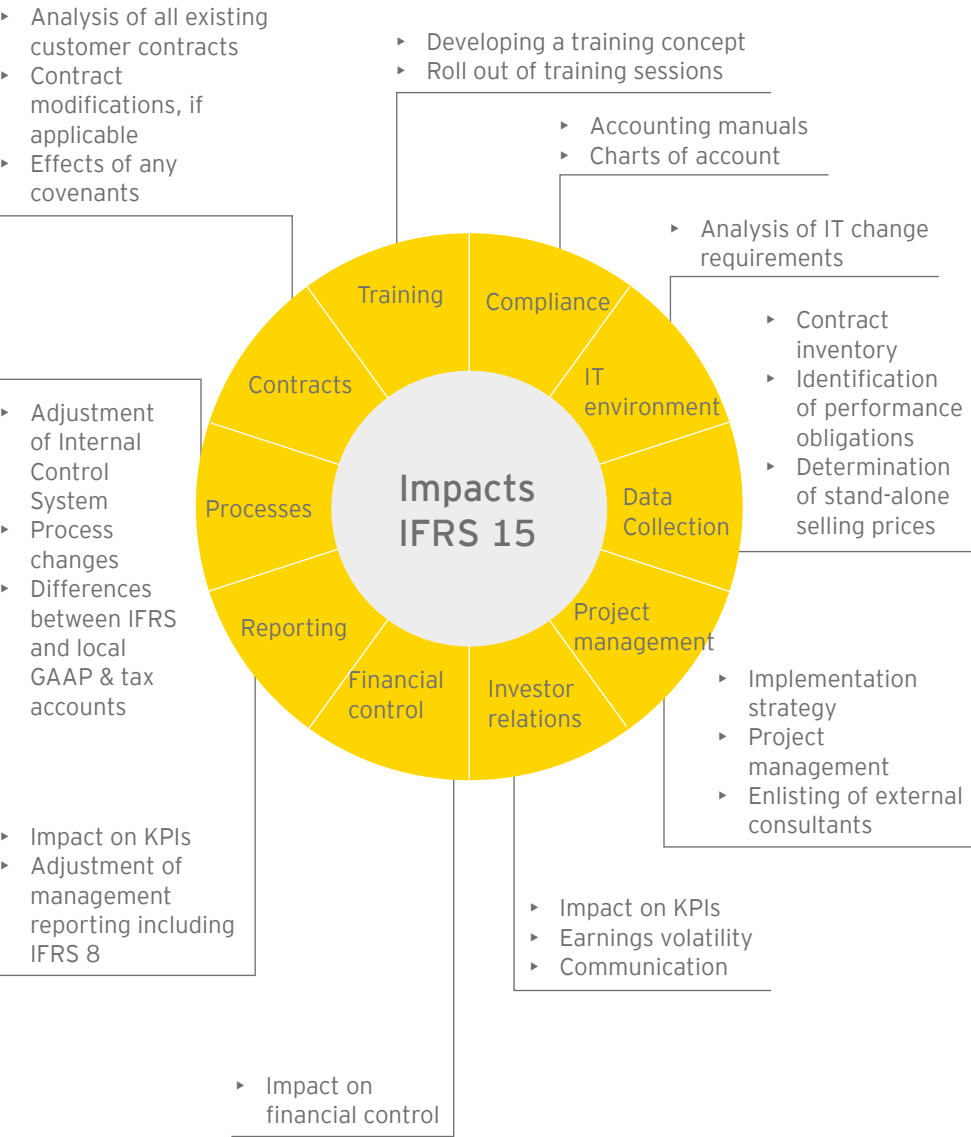
IFRS 15: Initial application

Early preparation will be key to a successful implementation of the new standard.



What needs to be considered?

The wheel shows the many impacts IFRS 15 might have for our clients and targets even if they do not belong to the focus sectors identified.



Sector specific challenges

Step	Heat map items	Aerospace and defense	FSO	Auto	Health care	Life sciences	Media & Entertainment	Oil and gas	Real estate	RCP	Software	Telecom
1	Identify the contract	H	L	L	M	M	M	L	M	M	M	M
2	Identify the performance obligations	H	L	H	H	H	H	M	M	H	H	H
3	Determine the transaction price	H	M	H	H	H	H	H	H	M	H	H
4	Allocate the transaction price	H	M	M	H	H	M	M	M	M	H	H
5	Recognize revenue	H	M	M	M	H	H	M	H	L	H	H

H

very high

H

high

M

medium

L

low

Specific issues for Telcom entities

- ▶ Entities might want to analyse whether the use of portfolio approach would be appropriate.
- ▶ Free goods and services as well as options for additional goods and services for a discounted price might be separate performance obligations.
- ▶ Removal of contingent revenue cap has implications on the estimate and the allocation of the transaction price. This will also result in a changed profile for revenue recognition (eg. more revenue for the handset).
- ▶ The accounting for contract modifications is complex and differs significantly depending on whether a new performance obligation is created and on the pricing.
- ▶ Extended payment terms might result in recognition of interest revenues.
- ▶ Frequently changing selling prices (eg. for handsets) result in different amounts allocated to similar goods included in different contracts.
- ▶ Capitalisation of subscriber acquisition costs required if incremental and recoverable.
- ▶ Due to the variety in prices and service offerings, the divergence between billing and accounting will lead to additional and complex system requirements.

Specific issues for Technology entities

- ▶ Thorough analysis of contracts for integrated solutions is necessary to conclude whether one or multiple performance obligations exist and what revenue recognition pattern is appropriate. The outcome is dependent on the degree of customization and integration of components as well as on the right to payment.
- ▶ Activities of the licensor after granting the license which significantly affect the granted IP might have consequences on the timing of revenue recognition.
- ▶ Renewal options might be separate performance obligations.
- ▶ Estimate of variable consideration (eg. price concessions, performance bonuses) requires significant judgment and an assessment of their potential reversal. Sales- or usage-based royalties are treated differently.
- ▶ VSOE requirement is no longer relevant; residual method is only applicable when strict criteria are fulfilled.
- ▶ Extended payment terms might result in recognition of interest revenues.
- ▶ The accounting for contract modifications is complex and differs significantly depending on whether a new performance obligation is created and on the pricing.

Specific issues for Life-Sciences entities

- ▶ Thorough analysis of collaboration agreements to develop a drug is necessary to conclude whether the whole agreement or only elements of it are in the scope of IFRS 15.
- ▶ Activities of the licensor after granting the license which significantly affect the granted IP might have consequences on the timing of revenue recognition.
- ▶ Detailed analysis of licensing agreements and collaboration agreements in scope is necessary to conclude whether one or multiple performance obligations exist and what revenue recognition pattern is appropriate.
- ▶ Non-observable stand-alone selling prices need to be estimated. The estimate of variable consideration (eg. milestone payments) requires significant judgment and an assessment of their potential reversal. Sales- or usage-based royalties are treated differently.
- ▶ Extended payment terms might result in recognition of interest revenues.
- ▶ Sell-through model for sales to distributors and consignment stock might no longer be appropriate.
- ▶ The accounting for contract modifications is complex and differs significantly depending on whether a new performance obligation is created and on the pricing.

Specific issues for Media & Entertainment entities

- ▶ Thorough analysis of collaboration agreements eg. to produce a film is necessary to conclude whether the whole agreement or only elements of it are in the scope of IFRS 15.
- ▶ Activities of the licensor after granting the license which significantly affect the granted IP might have consequences on the timing of revenue recognition.
- ▶ Detailed analysis of licensing agreements is necessary to conclude whether one or multiple performance obligations exist (is the license distinct?) and what revenue recognition pattern is appropriate.
- ▶ Criteria for Principal vs. Agent assessment remain unchanged.
- ▶ The estimate of variable consideration (eg. volume discounts) requires significant judgment and an assessment of their potential reversal. Sales- or usage-based royalties are treated differently.
- ▶ Non-cash consideration by the customer is included at its fair value in the transaction price.
- ▶ Free goods and services as well as options for additional goods and services for a discounted price might be separate performance obligations.

Specific issues for Automotive entities and Retail and Consumer Products entities

- ▶ The new standard requires an evaluation of all contracts as separate performance obligations may be identified. Specific issues for Automotive entities may include:
- ▶ Cash incentives and incentives to provide free or discounted goods can be separate performance obligations rather than marketing incentives.
- ▶ Promises to provide a good or service in the future can be separate performance obligations.
- ▶ The determination of whether a warranty is an assurance-type or service-type warranty will require professional judgment.
- ▶ Specific issues for Retail and Consumer Products entities may include:
- ▶ Professional judgment will be required in the estimation of returns and the accounting for loyalty programs, reseller agreements and licensing and franchising agreements.
- ▶ Revenue will need to be reported net of sales taxes as the transaction price must exclude any amounts collected on behalf of third parties.
- ▶ The determination of whether a warranty is an assurance-type or service-type warranty will require professional judgment.

Specific issues for Software entities

Identifying performance obligations:

- ▶ VSOE requirement is no longer relevant, additional performance obligations may be identified under the new standard and there is a possibility that revenue can be recognized earlier than today. The standalone selling prices will also no longer be estimated using VSOE.
- ▶ The determination of whether a warranty is an assurance-type or service-type warranty will require professional judgment.

Determining the transaction price:

- ▶ In the determination of variable consideration it will be challenging to distinguish between implied price concessions (i.e., reductions of revenue) and customer credit risk (i.e., bad debt).
- ▶ While the existence of extended payment terms in a contract likely creates variability in the transaction price, it might not result in the full deferral of revenue.
- ▶ Professional judgment will be required in assessing the significance of the financing component because the standard does not establish a quantitative threshold.

Recognizing revenue:

- ▶ It is possible that an output or input method will need to be developed that best depicts the pattern of transfer of control over time.

Specific issues for Real estate entities and Power and Utilities entities

Specific issues for Real Estate entities:

- ▶ When determining the transaction price, the main challenge will be the determination of the variable consideration taking into account a variety of factors.
- ▶ Significant judgment will be required when revenue is recognized over time. Difficulties can arise, eg. when determining whether services such as leasing or development activities are simultaneously received and consumed by the real estate owner.
- ▶ In case revenue is recognized at a point in time, sellers of real estate no longer need to consider their initial and continuing investment and continuing involvement, although they must conclude on the collectability of the transaction price.

Specific issues for Power and Utilities entities:

- ▶ Significant judgment will be required when identifying performance obligations, evaluating contracts with fixed and stepped pricing and when accounting for contract modifications.
- ▶ Rate-regulated entities will need to carefully consider whether their contracts fall within the scope of the new revenue guidance.

IFRS 15: Implementation

What can EY do for you?



- ▶ Understand the requirements of the new standard
- ▶ Determine the preliminary impact on the entity
- ▶ Identify significant revenue streams and analyze representative contracts under the new standard to understand the impact on all workstreams
 - ▶ Accounting and reporting
 - ▶ Revenue - measurement and timing
 - ▶ Disclosures
 - ▶ Tax
 - ▶ Business processes and systems
 - ▶ Change management
- ▶ Outputs of the diagnostic phase
 - ▶ Accounting and reporting workstream
 - ▶ Accounting training materials
 - ▶ Summary of revenue streams
 - ▶ Accounting position papers for representative contracts
 - ▶ Selection of transition method
 - ▶ All workstreams
 - ▶ Report summarizing preliminary assessment of affected areas and areas of focus to be built into the project plan



- ▶ Analyze outputs from the diagnostic phase
- ▶ Develop a detailed project plan based on the transition method selected to address the issues identified in the diagnostic for each workstream
- ▶ Monitor the project plan on an ongoing basis and continually update based on new feedback
- ▶ Outputs of the design and planning phase
 - ▶ All workstreams
 - ▶ Project management and budget
 - ▶ Detailed project plan
 - ▶ Communication and training strategy



- ▶ Develop solutions for the action items identified in the project plan
- ▶ Examples of outputs from each workstream:
 - ▶ Accounting and reporting: draft accounting policies in line with the new standard, accounting position papers analyzing additional contracts to determine the impact, an approach for calculating the cumulative catch-up adjustments (if any), draft disclosures to comply with new requirements
 - ▶ Tax: new and updated tax basis, changes in tax policies, redesigned tax reporting package, approach for calculating tax impact difference
 - ▶ Business processes and systems: systems requirements to comply with new standard, processes for implementing new standard, internal controls for newly developed processes
 - ▶ Change management: training materials for new processes, communication plan changes in compensation policies



- ▶ Rolling out solutions developed in the prior phase to the organization
- ▶ Examples of outputs from each workstream:
 - ▶ Accounting and reporting: 2017 F/S (including cumulative catch-up adjustment and new disclosures), updated accounting policy manual (distributed to accounting professionals)
 - ▶ Tax: updated tax accounting policies
 - ▶ Business processes and systems: updated business process and policy manuals, fully implemented accounting system
 - ▶ Change management: training sessions for professionals in all affected functions, memos from human resources on new compensation policies



- ▶ Monitor organizational implementation efforts
- ▶ Identify necessary updates and changes to processes, systems and policies to support continuous improvement
- ▶ Monitor peer efforts
- ▶ Conduct status meetings

Your EY contacts

Well-equipped and with a reliable compass in hand, you can tackle any journey and reach any destination – no matter how complicated the route or how ambitious the goal. Your EY Revenue Recognition Expert will give you the right tools to guide your company successfully through the many changes to IFRS 15.

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About EY

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